

Form 1040 in the amount of \$13x, the portion of their Federal income tax liability required to be paid to the USVI. H and W attach a Form 8689, "Allocation of Individual Income Tax to the Virgin Islands," to the Form 1040 filed with the Internal Revenue Service and to the copy of the Form 1040 filed with the USVI.

Example 5. J is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands (USVI). In 2005, J receives compensation for services performed in the USVI in the amount of \$40x. J prepares and files an Individual Income Tax Return, Form 1040, with the USVI and reports gross income of only \$30x. J has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for U.S. Federal income tax purposes and, therefore, must file a Federal income tax return in accordance with the Internal Revenue Code and the regulations.

Example 6. (i) N is a U.S. citizen and a bona fide resident of the U.S. Virgin Islands. In 2004, N receives compensation for services performed in Country M. N prepares and files an Individual Income Tax Return, Form 1040, with the USVI and reports the compensation as income effectively connected with the conduct of a trade or business in the USVI. N claims a special credit against the tax on this compensation purportedly pursuant to a USVI law enacted within the limits of its authority under section 934.

(ii) Under the principles of section 864(c)(4) as applied pursuant to section 937(b)(1) and § 1.937-3T(b), compensation for services performed outside the USVI may not be treated as income effectively connected with the conduct of a trade or business in the USVI for purposes of section 934(b). Consequently, N is not entitled to claim the special credit under USVI law with respect to N's income from services performed in Country M. Given that N has not fully paid his tax liability referred to in section 934(a), he has not satisfied the conditions of section 932(c)(4) and paragraph (c) of this section for an exclusion from gross income for U.S. Federal income tax purposes. Accordingly, N must file a Federal income tax return in accordance with the Internal Revenue Code and the regulations.

(j) *Effective date.* This section shall apply for taxable years ending after October 22, 2004.

[T.D. 9194, 70 FR 18931, Apr. 11, 2005, as amended by T.D. 9248, 71 FR 5001, Jan. 31, 2006]

§ 1.933-1 Exclusion of certain income from sources within Puerto Rico.

(a) [Reserved]. For further guidance, see § 1.933-1T(a).

(b) *Taxable year of change of residence from Puerto Rico.* A citizen of the United States who changes his residence from Puerto Rico after having been a bona fide resident thereof for a period of at least two years immediately preceding the date of such change in residence shall exclude from his gross income the income derived from sources within Puerto Rico which is attributable to that part of such period of Puerto Rican residence which preceded the date of such change in residence, except amounts received for services performed as an employee of the United States or any agency thereof.

(c) [Reserved]. For further guidance, see § 1.933-1T(c).

(d) [Reserved]. For further guidance, see § 1.933-1T(d).

(e) [Reserved]. For further guidance, see § 1.933-1T(e).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 9194, 70 FR 18934, Apr. 11, 2005]

§ 1.933-1T Exclusion of certain income from sources within Puerto Rico (temporary).

(a) *General rule*—(1) An individual (whether a United States citizen or an alien), who is a bona fide resident of Puerto Rico during the entire taxable year, shall exclude from gross income the income derived from sources within Puerto Rico, except amounts received for services performed as an employee of the United States or any agency thereof.

(2) The following example illustrates the application of the general rule in paragraph (a)(1) of this section:

Example. [Reserved]

(b) [Reserved]. For further guidance, see § 1.933-1(b).

(c) *Deductions and credits.* In any case in which any amount otherwise constituting gross income is excluded from gross income under the provisions of section 933, there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions (except the deduction under section 151, relating to personal exemptions), or any credit, properly allocable to, or chargeable against, the amounts so excluded from gross income. For

purposes of the preceding sentence, the rules of § 1.861-8 shall apply (with creditable expenditures treated in the same manner as deductible expenditures).

(d) *Definitions.* For purposes of this section:

(1) The rules of § 1.937-1T shall apply for determining whether an individual is a bona fide resident of Puerto Rico.

(2) The rules of § 1.937-2T shall apply for determining whether income is from sources within Puerto Rico.

(e) *Effective date.* This section shall apply for taxable years ending after October 22, 2004.

[T.D. 9194, 70 FR 18934, Apr. 11, 2005, as amended by T.D. 9248, 71 FR 5001, Jan. 31, 2006]

§ 1.934-1 Limitation on reduction in income tax liability incurred to the Virgin Islands.

[Reserved]. For further guidance, see § 1.934-1T.

[T.D. 9194, 70 FR 18935, Apr. 11, 2005]

§ 1.934-1T Limitation on reduction in income tax liability incurred to the Virgin Islands (temporary).

(a) *General rule.* Section 934(a) provides that tax liability incurred to the United States Virgin Islands (Virgin Islands) shall not be reduced or remitted in any way, directly or indirectly, whether by grant, subsidy, or other similar payment, by any law enacted in the Virgin Islands, except to the extent provided in section 934(b). For purposes of the preceding sentence, the term “tax liability” means the liability incurred to the Virgin Islands pursuant to subtitle A of the Internal Revenue Code, as made applicable in the Virgin Islands by the Act of July 12, 1921 (48 U.S.C. 1397), or pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands (48 U.S.C. 1642), as modified by section 7651(5)(B).

(b) *Exception for V.I. income—(1) In general.* Section 934(b)(1) provides an exception to the application of section 934(a). Under this exception, section 934(a) does not apply with respect to tax liability incurred to the Virgin Islands to the extent that such tax liability is attributable to income derived from sources within the Virgin Islands or income effectively connected with

the conduct of a trade or business within the Virgin Islands.

(2) *Limitation.* Section 934(b)(2) limits the scope of the exception provided by section 934(b)(1). Pursuant to this limitation, the exception does not apply with respect to an individual who is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands). For the rules for determining tax liability incurred to the Virgin Islands by such an individual, see section 932(a) and the regulations thereunder.

(3) *Computation rule—(i) Operative rule.* For purposes of section 934(b)(1) and this paragraph (b), tax liability incurred to the Virgin Islands for the taxable year attributable to income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands shall be computed as follows:

(A) Add to the income tax liability incurred to the Virgin Islands any credit against the tax allowed under mirrored section 901(a);

(B) Multiply by taxable income from sources within the Virgin Islands and income effectively connected with the conduct of a trade or business within the Virgin Islands (applying the rules of § 1.861-8 to determine deductions allocable to such income);

(C) Divide by total taxable income; and

(D) Subtract the portion of any credit allowed under mirrored section 901 (other than credits for taxes paid to the United States) determined by multiplying the amount of taxable income from sources outside the Virgin Islands or the United States that is effectively connected to the conduct of a trade or business in the Virgin Islands divided by the total amount of taxable income from such sources.

(ii) *Limitation.* Tax liability incurred to the Virgin Islands attributable to income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands, as computed in this paragraph (b)(3), however, shall not exceed the total amount of income tax liability actually incurred.